Research Paper

The Economic Effects of Financial Reporting Transparency in capital markets

By

Zamzam Ahmed Abobakr
Department of Accounting
Faculty of Commerce & Business Administration
Helwan University

Presented to

Prof. Dr. Hamdy kadous
Professor of Financial Accounting
Faculty of Commerce & Business Administration
Helwan University

2012

The Economic Effects of Financial Reporting Transparency

in capital markets

Abstract:

The purpose of this study is to discuss the existing literature about transparency , how to measure, and whether the transparency and disclosure level (T&D) of firms is enhanced by the promulgation of a set of local Corporate Governance (CG) Principles and by the adoption of the accounting Standards , and discuss the impact of transparency on accounting quality and its economic effects in capital markets, In terms of the impact of transparency on cash flows and cost of capital, I find that there are positive relation among transparency and cash flows, firm value, Corporate Governance, and the adoption of accounting Standards. While negative relation between transparency and both of earning management and cost of capital.

Key Words:

Transparency and disclosure (T&D), Corporate Governance, accounting quality, Accounting Standards, Cost of capital, Cash Flows

Introduction:

Three recent trends have spurred the debate about financial reporting transparency and disclosure regulations around the world. **First**, international financial crises and corporate scandals often bring about securities regulation reforms and greater reporting and disclosure requirements. The Asian Financial Crisis of 1997, the Enron debacle in the U.S., and the recent credit market crisis are but a few important examples. In the aftermath of these events, regulators and policy makers have called for improved corporate transparency, increased scrutiny and often enacted significant changes to accounting and disclosure requirements and regulations. **Second**, stock exchanges and accounting standards bodies from numerous countries around the world have adopted International Financial Reporting Standards (IFRS) to achieve the stated goal of "harmonization" and "convergence" of accounting rules. **Third**, both the debate about the competitiveness of U.S. capital markets and the increasing internationalization of capital markets highlight securities regulation as a global issue**.**

Full disclosure and transparency (T&D) of financial information are vital components of the corporate governance (CG) framework and are regarded as an important indicator of CG quality. Indeed, firms with higher CG quality make more informative disclosures. And then, I think that transparency reduce the opportunistic behavior of management to serve its benefits at the expense of shareholders.

The lack of transparency in annual reports is a failure of financial statements to fully reflect the economic performance of the reporting entity. There are however problems with the notion of transparency as it tend to mask the fact that financial statement producers are not properly communicating economic performance with their accounting reports. There are fundamental problems with the accounting model as a vehicle for expressing the complex reality of business performance.

Transparency in financial reporting play a key role in raising the efficiency of capital markets, which achieves the best allocation of available resources. Transparency helps investors, lenders, and other market participants to assess the financial situation of the company and then help them make investment decisions and sound credit and ultimately can help to increase the degree of confidence in the capital market.

Thus, the transparency comes at the top of the list of issues of interest to traders in the stock market and the regulators for the market. This is because transparency is to ensure justice among the players in the market and prevent any party to takeover of information is not available for the other.

In this paper, I discuss the existing literature about transparency , how to measure it and its economic effects in capital markets, In terms of the impact of transparency on cash flows and cost of capital. So I will divide this paper as follow:

1. Corporate transparency: a theoretical framework

1.1 Transparency definition
1.2 Measuring Transparency
1.3 The challenges of Transparency

2. The role of transparency in corporate governance and Earnings Management

3. The impact of information transparency on accounting quality.

4. Accounting standards and information transparency (increased or decreased).

5. The Economic Effects of Transparency in capital markets.

5.1 Transparency and Cash Flows

5.1.1 Efficient Resource Allocation
5.1.2 Asset Expropriation

5.2 Transparency and Cost of Capital.

5.2.1 The Relation between Transparency and Firm Equity Value
5.2.2 The role of transparency in reducing information asymmetry
5.2.3 Transparency and Average Liquidity
5.2.4 Transparency and Liquidity Uncertainty
5.2.5 Transparency and Investor Attention
5.2.6 Transparency and Estimation Risk
5.2.7 The role of transparency in protecting small investors

6- Financial reporting transparency in Egypt.

7- Future Research.

8. Conclusions.

1. Corporate transparency: a theoretical framework

1.1 Transparency definition:

The word "transparent" can be used to describe high-quality financial statements. The term has quickly become a part of business vocabulary. Dictionaries offer many definitions for the word, but those synonyms relevant to financial reporting are: "easily understood", "very clear", "frank" and "candid"

It is different views on the concept of transparency, whether generally or in accounting, as well as how it relates with the concept of disclosure. So, Transparency defined as:

- Corporate transparency, defined as the availability of firm-specific information to those outside publicly traded firms, and viewed as the joint output of multi-faceted systems whose components collectively produce, gather, validate and disseminate information to market participants ***(Bushman, 2004, p.209)***

The availability of a publicly traded corporation's firm-specific information includes annual reports, required disclosures, analyst reports and voluntary disclosures to users not directly connected with the firm's operations (e.g. management and other firm insiders),but also the availability of such information may be important to a wide range of constituents, including equity holders, debt holders, government agencies and labor unions.

- In terms of financial statements one definition of transparency is making apparent "the underlying economics of the business and its transactions" (**Aksu, 2006)**.

This definition is qualified in that the financial statements must be comprehensible to those who have a reasonable understanding

- Financial transparency is the availability of firm-specific financial information to equity stakeholders and the effects of the quantity and quality of that information on own-firm equity value ***(Lang & Maffett, 2011 b, p. 5)***.

- Standard & Poor's definition of T&D: timely and adequate disclosure of the operating and financial performance of the firm and its corporate governance practices related to its ownership, board, and management structures and processes. Understandable, relevant, transparent, reliable, timely, and full disclosure of the results of economic activities and the structure and processes used in its organizational units entrusted to

operate in shareholders' interests, gives the stakeholders a true and fair view of the firm and the quality of the CG standards it follow ***(Aksu,2006)***

From the above, it is clear that the concept of transparency focuses on the clarity, sincerity of the information, the timeliness, and adequacy of information for decision-making and hence, the researcher suggests the following concept:

"Transparency is reliable, timely and adequate disclosure of the domestic and private information, and any other information affecting the stock price (information of corporate governance) ,which are used in the decision-making".

But the question, Is there a difference between transparency and disclosure in financial reports?

Some people believe that the disclosure of additional information can normally be assumed to enhance transparency (***Schuster & Hjelström , 2008, p.5),*** others say that disclosure requires information to be transparency, so it knows that the disclosure is provision the information of all kinds in a timely and reliable manner, while the disclosure transparency is the practical measures to provide good disclosure requirements ***السهلى،***) (***2010***

However, some studies such ***(Aksu,2006)*** used one indicator to measure the degree of disclosure and transparency on the grounds that there is no fundamental difference between them as a result of overlapping of their jobs and goals.

Therefore, **my view**, that the two concepts are complementary and not alternative; it can not be achieved transparency without disclosure, and the disclosure without transparency is not useful. Consequently, I agree with ***(Wahba, 2005)*** that Transparency means the cerates environment from which to see the information clearly, and that this information is understandable. While disclosure is the procedures and means by which information is published.

.1.2 Measuring transparency:

Some of researchers show measures for the transparency of disclosure, for example, the measure presented by Bushman et al. (2004)

The framework of conceptualizing and measuring information systems that contribute to corporate transparency categorize country level measures of information mechanisms under three headings ***(Bushman, et al.,2004, p.207)***

1) The corporate reporting regime, including measures of intensity, measurement principles, timeliness, and audit quality of financial disclosures, and the intensity of governance disclosures (i.e. identity, remuneration, and shareholdings of officers and directors, identity and holdings of other major shareholders),

2) The intensity of private information acquisition, including measures of analyst following, and the prevalence of pooled investment schemes and insider trading activities

3) Information dissemination, including a measure of the extent of media penetration in an economy.

Also, some international organizations presented indicators of transparency and disclosure, for example, the indicator which presented by the Organization Development and International Cooperation (OECD). According to this indicator the transparency of disclosure achieve in financial reports if they contain the disclosure eight basic are: the financial and operating information, the objectives of the company, principal owners of the shares and the rights of vote, board members, managers, transactions with related parties, the risks facing the company, employees and the parties with interests in the company, and the governance measures and structure ***(OECD ,2004)***

Also the American Institute of Certified Public Accountants believes that to achieve transparency it requires the disclosure of

- Financial and non- Financial information.
- Managements analysis of Financial and non- Financial data.
- Forward looking information.
- Information about management and shareholders.
- Background about accompany.

Despite the attempts of researchers and organizations in this regard, the measure most famous and it has relied on most - if not all - studies that have measured the transparency of disclosure is that the scale presented by the Standard & Poor's finances. According to this measure achieved transparency in financial reporting if it includes the disclosure in these reports 83 item or information from the information necessary for investors to take investment decisions, giving those items weights or points made up according to their importance to investors, bringing the total points in this scale to 98 points.

Standard & Poor's has introduced a methodology to assess the level of transparency and disclosure along these three dimensions: ***.(Patel et al., 2002 ,pp. 328- 330)***

(a) Ownership structure and investor relations (28 attributes)
(b) Financial transparency and information disclosure (35 attributes)
(c) Board and management structure and process (35 attributes)

The results of T&D score analyze for available annual reports for over 1600 large and liquid companies in over 30 countries and assess the level of transparency by searching company annual reports for the inclusion of 98 possible information items ('attributes')

The distribution of T&D scores by economic sectors is less interesting. The only outlying sector is Utilities with an average T&D score of 34, compared to the average score of 43 for information technology, and of 42 for Health and Telecommunications. This difference in T&D scores by economic sectors might be related to the ownership structures: utilities in emerging markets are largely state owned and recently privatized, the Health Care sector has a history of ownership by foreign companies, telecommunications services stocks have foreign listings, and the information technology sector is largely owned by first generation entrepreneurs.

The following table shows the general level of transparency in some countries ***(patel et al., 2002 ; Elsahly, 2011)***

Country	**Percentage** (%)
America	98
Saudi Arabia	69.6
South African	55
Thailand	49
Korea	45
China	44
Malaysia	43
Hungary	43
India	40
Indonesia	38
Pakistan	37
Poland	36
Turkey	34
Brazil	32

Chile	32
Philippines	29
Egypt	**40**

Despite the importance of Standard & Poor's Transparency and Disclosure Rating, several proprietary manual disclosure scorings and companies' own assessment of their level of disclosure. However, empirical research on voluntary disclosure lacks an appropriate measurement technique for quantifying the intensity of firm's disclosure, a computerised technique for measuring disclosure using Artificial Intelligence Measurement of Disclosure (AIMD), which derives disclosure proxies from English-language annual reports for ten different information dimensions without human involvement. AIMD is negatively associated with information asymmetry, and the applicability of AIMD is a cost-effective technique for measuring disclosure ***(Grüning, 2010)***

1.3 The Challenges of Transparency:

In practice, all firms do not disclose the maximum possible at all points in time, reflecting the fact that, while there may be benefits associated with increased disclosure, there are also likely to be costs. There has been relatively little research on the potential costs to transparency, because they are difficult to measure. That being said, there are several types of costs - which I argue that are challenges to increasing transparency- that are (***Lang, Maffet, 2011*** b):

1.3.1 Direct costs of transparency:

For example, hiring a 'Big 5' auditor is likely more expensive than hiring a local auditor. Similarly, adopting U.S. GAAP or IFRS is likely to be more expensive than staying with local accounting standards. In general, maintaining an elaborate investor relations effort clearly involves substantial costs that may outweigh potential benefits. This is particularly true if the benefits of transparency accrue primarily to the equity investors rather than to other stakeholders. For example, private debt holders do not rely as heavily on publicly-available information because they have more direct access to management, thus the direct cost of increased transparency may exceed the benefit to them.

But it must be tradeoffs between cost and benefits when choosing an accounting system which achieves transparency, so as benefits to be more than the cost of providing information and disclosure about it.

1.3.2 Interests conflict between managers and stockholders:

Stockholders need to additional information to evaluate management performance, while the managers disclose information that serves their purposes only and achieving high compensations for them.

1.3.3 Fear of failure to achieve a competitive advantage:

A firm may be reluctant to disclose for fear the release of proprietary information may benefit competitors.

In addition, the researcher believes that the **legal, judicial and political systems** may have an impact on the level or degree of transparency, the quantity and quality of information to be disclosed.

Bushman et al. (2004) emphasis that financial and governance transparency factors vary with countries' legal / judicial regimes and political economies. Governance transparency is higher in countries with a legal / judicial regime characterized by a common law legal origin and high judicial efficiency. In contrast, financial transparency is higher in countries where the political economy is characterized by low state ownership of enterprise, low state ownership of banks, and low risk of state expropriation of firms' wealth.

Also, I argue that the **culture** of financial reporting preparers and management may be affecting the degree of transparency and disclosure.

2. The Role of Transparency in Corporate Governance and Earnings Management:

In response to recent corporate governance scandals, governments have responded by adopted a number of regulatory changes. One component of these changes has been increased disclosure requirements. For example, Sarbanes-Oxley, adopted in response to Enron, Worldcom, and other public governance failures, required detailed reporting of off-balance sheet financing and special purpose entities. Additionally, sox increased the penalties to executives for misreporting. The link between governance and transparency is clear in the public's (and regulators') perceptions; transparency was increased for the purpose of improving governance.

Transparency and disclosure are integral to corporate governance. Higher transparency and better disclosure reduce the information asymmetry between a firm's management and financial stakeholders—equity and bond holders, mitigating the agency

problem in corporate governance. The agency problem in corporate governance can be mitigated in practice in several ways: by a vigilant board of directors, by timely and adequate disclosure of financial information, and possibly by a transparent ownership structure clarifying the conflict of interests in allowing majority shareholders or large creditors to Manage the company (***Patel et al., 2002, p.325).***

The quality of information the firm discloses as a choice variable that affects the contracts the firm and its managers. Through its impact on corporate governance, higher quality disclosure both provides benefits and imposes costs. The benefits reflect the fact that more accurate information about performance allows boards to make better personnel decisions about their executives. The costs arise because executives have to be compensated for the increased risk to their careers implicit in higher disclosure levels, as well as for the incremental costs they incur trying to distort information in equilibrium. These costs and benefits complement existing explanations for disclosure. Moreover, because they are directly about corporate governance, they are in line with common perceptions of why firms disclose information (***Hermalin & Weisbach,2007, p.1).***

Relevant disclosures to the investing public are one form of corporate governance, since a reduction in information asymmetry is an essential objective of corporate governance. Public disclosures represent at least one potential solution to agency problems arising from the information asymmetry; hence, extensive and high quality disclosures should be an integral part of strong corporate governance. It follows that information about firms' disclosure policies should thus be relevant to investors' investment decisions, especially in periods following revelations of accounting scandals ***(Cheng et al.,2006,p.2)*** .

In addition, the transparency is one of foundations of corporate governance where help the Board of Directors in assess the effectiveness of executive management and enable it to take corrective action early before the occurrence of any defect in the financial position of the company.

Also, Participants indicate they believe **Earnings Management** in the less transparent setting will improve stock price and have no effect on their reputation for reporting integrity, whereas EM in the more transparent setting will damage both. Results of this study suggest that more transparent reporting requirements will reduce EM attempts or change the focus of EM attempts to less visible methods***.(Hunton et al., 2004)***

The results of ***(Lang & Maffett, 2011)*** suggest that innately smooth earnings may increase transparency, while greater discretionary smoothing may decrease transparency.

In other words, the “normal” smoothing properties of accruals are associated with greater transparency as intended by the accounting system, but that “excess” smoothing is associated with greater opacity.

(**Kim et al., 2011)** tested the relationship between transparency and earnings management by examining the impact of the obligation social responsibility on the earnings management, they find that corporate social responsibility (CSR) firms are less likely to engage in aggressive earnings management. Specifically, CSR firms appear to reduce or avoid earnings manipulations through discretionary accruals, as compared to non-CSR firms. They also find evidence that CSR firms are less likely to engage in real activities manipulation. Thereby CSR firms delivering more transparent and reliable financial information to investors as compared to other firms that do not meet the same social criteria.

And then, I think that transparency reduce the opportunistic behavior of management to serve its benefits at the expense of shareholders.

3. The impact of information transparency on accounting quality:

The empirical results for (***Hsieh*, *2011***) indicated that information transparency and accounting quality are not highly related, although they are more related in the electronics industry than in other industries**.**

Also, new conceptual framework the (IASB) and (FASB) considers that it would be “redundant” to include the concept of transparency among the other qualitative characteristics of decision-useful information mentioned in their conceptual frameworks. **The reason for this is** that transparency is seen to arise from applying other qualitative characteristics ***(Schuster & Hjelström, 2008, p.2)***

On the contrary, **(Aksu, 2006, p. 2)** fined that Full disclosure and transparency (T&D) of financial information are regarded as an important indicator of CG quality. The higher CG quality makes more informative disclosures **.**

Transparency and disclosure is one of the main characteristics of the quality of financial reporting, which should be available in these reports to be able play the role expected of them ***(السهلى ، 2011)***

Armstrong et al. (2012), examine the relation between corporate governance and firms' information environments (transparency) .They found that information asymmetry and private information gathering decreased because of corporate governance , and financial statements informativeness increased following the passage of the antitakeover

laws. The increased level of financial statement informativeness is the feature to firms that are most likely to access equity markets.

4. Accounting standards and transparency: increased or decreased?

(Aksu, 2006) argue that voluntary IFRS adoption seems to be a credible signal of commitment to transparency and full and reliable disclosure. Also, the relationship between TD scores and performance are higher in early adaptors. Firms are expected to have higher T&D scores due to adopting IFRS and CG Principles**. *(Aksu, 2006)***

Also**, *(Lara,2008,p.6)*** argue that The implementation of IFRS is expected to contribute to increased transparency in both Europe and China .

However**,** mark-to-market accounting (also known as “fair value” accounting) reduces financial reporting transparency and creates information asymmetry in the market for banks’ shares ***(Ball et al.,2011,p.2)***.

As for the international accounting standards, it supports transparency and disclosure in financial reporting through more disclosures in number of the standards such as:

- IAS 1 Presentation of Financial Statements.
- IAS 10 Events after the Reporting Period.
- IAS 20 Accounting for Government Grants and Disclosure of Government Assistance.
- IAS 24 Related Party Disclosures
- IFRS 7 Financial Instruments: Disclosures.
- IFRS 8 Operating Segments
- IFRS 12 Disclosure of Interests in Other Entities.

While the **Egyptian Accounting Standards**, requirement the above disclosures but did not deal with non-financial disclosures in the notes of financial statements, such as disclosure of operating data and performance measurements (such as information about productivity, customer satisfaction, growth in sales, information about quality and risk of competition).

5. The Economic Effects of Transparency in capital markets:

Transparency is positively associated with the correlation in industry-specific growth rates across country pairs. This positive association is consistent with the notion that corporate transparency helps channel resources to those particular industries with good growth opportunities and hence contributes to more effective intersectoral allocation

of resources. Also, the impact of corporate transparency on the co movement in growth rates is greater for country pairs at similar levels of economic development ***(Francis et al., 2010, p.5).***

In this section I discuss the existing literature on the economic effects of transparency in capital markets, which make it a fruitful environment for investigating these effects and suggest directions for future research

5.1 Transparency and Cash Flows:

Transparency can affect cash flows through at least two related channels. **First**, transparency affects the ability of investors to monitor managers and, therefore, may provide incentives for them to operate the business more efficiently. **Second**, transparency reduces managers' ability to expropriate assets for their own benefit or the benefit of other related parties.

Transparency can improve investment efficiency, and thereby improving performance and achieving economic growth as a whole in at least two ways:

5.1.1 Efficient Resource Allocation

The contemporaneous correlations in industry growth rates across country pairs are higher when there is a greater level of corporate transparency in the country pairs, after controlling for country-level economic and financial development. Second, we find the influence of transparency on these correlations is stronger when country pairs are at similar levels of economic development (GDP). Finally, when we control for the level of transparency explained by a country's institutions in place, we find that residual transparency (unexplained by country-level factors) is associated with industry-specific growth rates. Taken together, the results are consistent with corporate transparency facilitating the allocation of resources across industry sectors ***(Francis et al., 2010)***

Transparency provides the opportunity for investors to observe and potentially discipline the actions of managers and, therefore, encourages managers to act in investors' best interests. (***Stulz,2009)*** describes how, in publicly-traded firms, managers have the opportunity to profit at the expense of shareholders by consuming the private benefits that arise from their direct control of the day-to-day operations of the firm. If the incentives of managers and shareholders are not aligned, managers may have incentives to invest in projects, even if those projects are not optimal from the shareholders' perspective, because management consumes private benefits from the firm's productive activities***.(Stulz ,2009)*** also constructs a simple model that shows greater transparency allows shareholders to monitor managerial production decisions and guard against overinvestment. In such a

setting, a credible commitment to increased transparency can lead to increased investment efficiency.

A closely-related notion is that transparency may improve the efficiency of resource allocation by improving the information available to managers. In other words, if managers need to gather information for external reporting, they may also use that information for better internal decision making. ***(Lambert, et al., 2007)*** models this idea analytically, allowing information quality to affect firm decision making with regard to production and investment. They show that, as information quality affects decisions, it changes the ratio of expected cash flow to non-diversifiable covariance risk and thus also affects cost of capital. They then show under what conditions an increase in information quality can lower a firm's cost of equity capital through its effect on firm investment decision making

The researcher believe that firms with greater transparency, investors are better able to monitor managers' decisions and, as a consequence, managers are more likely to pursue only value-enhancing (positive net present value) projects.

Transparency is important for limiting poorly-performing projects because, absent oversight, managers can pursue negative net present value projects for private benefit with a low probability of detection

5.1.2 Asset Expropriation and excessive perquisite consumption.

The issue is not a manager's choice of projects but, rather the notion that they may use their position of control to increase personal consumption or reward large block holders and other privileged stakeholders at the expense of minority shareholders. Higher levels of transparency potentially make it more difficult for insiders to expropriate assets from the firm without detection by other stakeholders

An alternate, but closely related, channel through which financial reporting transparency may be linked to firm cash flows is asset expropriation and excess perquisite consumption. The agency conflicts between investors and managers, expected to arise as a result of the separation of ownership and control that defines a public corporation. This literature highlights the notion that such agency conflicts create incentives for managers to expropriate from the firm for their own personal benefit. The distinction relative to the preceding issue is the extent to which the actions are explicitly opportunistic on the part of managers. In particular, the types of potential effects here include, for example, tunneling of assets by managers and large block holders clearly, the expropriation of assets and consumption of private benefits reduces the firm's cash flows to shareholders.

Researcher believes that the financial statement transparency plays an important role in mitigating agency conflicts because it increases the ability of outsiders to detect expropriation and excess perquisite consumption, and thus reduces managerial and insider incentives to undertake such activities. In this way, transparency can increase expected cash flows available to investors and thus increase share prices

(Jian and Wong ,2006), attempt to examine earnings management and asset expropriation through related party transactions. Their results suggest, for a sample of Chinese firms, that managers use earnings management to create opacity which in turn they use to siphon off excess profits from the firm.

5.2 Transparency and Cost of Capital:

One of the challenges in drawing links between transparency and cost of capital is in determining the path through which the relation might obtain. In general, transparency would be expected to reduce uncertainty about intrinsic value. However, uncertainty about intrinsic value would not necessarily translate into an effect on cost of capital for at least two reasons. First, to the extent stock price variability is idiosyncratic, it would not generally be priced in equilibrium. In particular, in frameworks such as the CAPM, only systematic stock price variation is priced. Thus, while transparency might reduce, for example, the frequency of large stock price changes, it is not immediately clear that increased transparency would reduce co variation in stock returns.

Second, even if stock return volatility was important to valuation, it is not clear that increased transparency would reduce stock return volatility. Under the assumption that the priced attribute (e.g., future dividends) eventually becomes known, additional disclosure can accelerate price discovery, but will not necessarily affect overall stock price variability. For example, timely preemptive disclosure of earnings information will increase share price movements during the period, but reduce share price movements at the earnings announcement. As a result, in an efficient market, preemptive disclosure of information may move the variability of prices in time, but will not necessarily change the overall variance of returns.

(Barth et al.,2008) find that firms with more transparent earnings have a lower cost of capital as reflected in cross-sectional variation in subsequent excess returns and mean differences in returns, after controlling for the Fama-French and momentum factors. They also find that more transparent earnings are significantly negatively associated with expected equity cost of capital.

To overcome these conceptual hurdles, authors have taken several approaches to incorporate transparency into the cost of capital. It the subsequent sections I discuss the most common of these approaches.

5.2.1 Transparency and Firm Equity Value

The importance of transparency is working to increase the information in the notes leading to improved disclosure in companies, where the lack of this information may lead to some investors make incorrect decisions. As well as the lack of this information - internal information - Works on Upload Artificial increase of prices and speculation, thus creating a kind of confusion and chaos to the level of performance in the market. And it can be argued that transparency would reduce the impact of rumors and the exploitation of inside information, so as not to have the opportunity in front of some speculators to obtain information not available to others.

Transparency affects share price and share price is represented as the present value of future cash flows. Present values are determined by discounting the expected cash flows at the firm's cost of equity capital. As a consequence, transparency could affect share price by influencing expected future cash flows, the discount rate, or both ***(Lang & Maffett, 2011 b, p. 7)***:

.5.2.2 Transparency and information asymmetry:

A commitment to increased levels of disclosure reduces the possibility of information asymmetries arising either between the firm and its shareholders, or among potential buyers and sellers of firm shares. This, in turn, should reduce the discount at which firm shares are sold, and hence lower the costs of issuing capital ***(Leuz & Verrecchia, 2000, p.2)***

5.2.3 The average level of liquidity:

. Prior research suggests that, to the extent firms are less transparent; the average level of liquidity is likely to be lower. These effects can operate through two related mechanisms.

- **First**, in terms of transactions costs, for a firm with an opaque information environment, market makers facing information asymmetry will increase the bid-ask spread to protect against informed trading.
- **Second**, for a firm with low transparency, trading frequency will decrease as investors become less willing to transact, making it more difficult to enter and exit positions. As

a result, demand for shares will drop as investors are discouraged by the high costs of trading and the likely difficulty of quickly entering and exiting positions. These effects ultimately drive down share price and increase cost of capital. Therefore, higher levels of transparency can reduce information asymmetry, increase trading frequency and thus increase liquidity and lower cost of equity capital.

5.2.4 Liquidity Uncertainty and Risk:

Liquidity uncertainty encompasses a variety of dimensions of the riskiness of an asset's liquidity, including its volatility, skewness, and co variability with market liquidity and market returns. Liquidity uncertainty is important to investors because what ultimately matters most is not the average level of liquidity, but the liquidity of a firm's shares at the time they choose to transact. Transparency can ameliorate the effects of liquidity uncertainty by, for example, reducing uncertainty about an asset's fundamental value and thereby increasing the ease with which market speculators can obtain funding for trading in the asset. Transparency can mitigate these aspects of liquidity uncertainty by increasing liquidity and capital providers' willingness to remain in the market, even when uncertainty is high***. (Lang & Maffett, 2011 a ; Sadka,2011, p. 145)***

Liquidity risk defined as the sensitivity of stock returns to unexpected changes in market liquidity ***(Ng,2010),***

firms with greater transparency (based on accounting standards, auditor choice, earnings management, analyst following and forecast accuracy) experience less liquidity volatility, fewer extreme illiquidity events and lower correlations between firm-level liquidity and both market liquidity and market returns. Results are robust to numerous sensitivity analyses, including controls for endogeneity and propensity matching. Results are particularly pronounced during crises, when liquidity variances, covariances and extreme illiquidity events increase substantially, but less so for transparent firms. Finally, liquidity variance, covariance and the frequency of extreme illiquidity events are all negatively correlated with Tobin's Q***.(Lang & Maffett,2011 a ,p.1)***

5.2.5 Investor attention.

If public information about a firm is not readily available at low cost, investors are less likely to follow the stock and, accordingly, will not invest in it. If transparency is higher, more information will be available to outsiders at low cost, increasing the likelihood the stock will enter their choice set, which ultimately increases their likelihood of investing. This increased demand will raise share price and lower cost of capital, all else equal.

5.2.6 Estimation risk:

Much of asset pricing theory assumes that investors know the underlying parameters of, for example, the variance/covariance matrix of expected cash flows. However, if investors do not know the parameters of the underlying cash flow process and are instead forced to estimate them, this can lead to incorrect assessments of, for example, the covariance of a firm's cash flows with market-wide cash flows (i.e. cash flow beta). Investors need information about an asset's covariance with other assets to form efficient portfolios and transparency enhances their ability to make these assessments. A firm's level of transparency determines, in part, the extent to which investors have the information to form efficient portfolios and if investors have more information they potentially take on less risk and will be willing to pay more for shares.

Lang, and Maffett (2011 a) documents a positive relation between transparency levels (as measured by auditor quality, accounting standard quality, earnings management, analyst following and analyst forecast accuracy), and cost of equity capital

I view that firms with higher transparency and disclosure are valued higher than comparable firms with lower transparency and disclosure.

5.2.7 The role of transparency in protecting small investors

The presence of pessimism for small investors in the capital market resulting from stress and fear of risk because of the popularity of market rumors and lack of transparency leading to loss of confidence of these investors in the market, especially after falling into the trap of losses (financial crisis),

Confidence can be returned to the small investors in stock market gradually as a result of the flow of information more transparent, thus increasing the awareness of small investors to allow them to make sound decisions, and government intervention to protect them by imposing new conditions on the market and controls on brokerage firms and brokers.

6- Financial reporting transparency in Egypt

There are many values and principles that the Capital Market Authority and its staff have the obligation to uphold and apply it, such as (Integrity - Justice - Transparency - Responsibility – Efficiency…..). Authority shall apply the distinct style in dealing with the parties to the market ,which depends on the transparency to achieve the trust of these parties in the performance of the Authority. And expect the same level of transparency of

those parties. The general level of transparency in financial reporting in Egypt amounted to about 40%

At the regional level, the Emirates country continued to the top of the transparency of listed companies over the Internet, followed by Oman and Egypt, which was classified this year ***(http://www.alqabas.com.kw/Article.aspx?id=753885***)

In Egypt, the main, official, financial-disclosure vehicle for listed companies is the annual report. All companies listed on the Egyptian Stock Exchange (ESE) must comply with the disclosure rules required by the Capital Market Law (CML) 95 of 1992. They are required to provide copies of their annual and semi-annual financial statements to both the Capital Market Authority (CMA) and the ESE and to publish a summary of them in two daily newspapers, at least one of which must be in Arabic. Mandatory financial disclosure includes the balance sheet, the income statement, the cash flow statement, the statement of changes in equity, the notes to the accounts, the board of directors' report, and the external auditor's report. In preparing their financial statements, companies are required to comply with Egyptian Accounting Standards (EAS), which are in conformity with IAS with some minor exceptions In the absence of specific EAS standards regarding an accounting practice, IAS must be applied The CMA reviews financial statements of listed companies and auditors' reports to ensure timely and full compliance with the Egyptian Accounting and Auditing Standards. In the case of noncompliance, the CMA requests the noncompliant company to publish the missing information. If a company fails to comply with this request, the CMA can publish details of the noncompliance. Also, the CMA can suspend or de-list securities of noncompliant companies.

With respect to non-financial disclosures, some are regulated, such as share class voting rights, board remuneration, and details of board members and senior management. However, it is up to the company to decide on the level of detail it reveals to the public. Ethical and environmental disclosures are rare or nonexistent ***(Hassan, et al., 2009, pp. 79 -102)***

As for the efforts of various agencies to increase transparency in the Egyptian market it is represented in (***Abd El mlek,2006***):

1 - Capital Market Authority in Egypt:

A - The Capital Market Authority demanded more disclosures, such as:

- Prohibits firms from disclosing value relevant information to selective capital market participants without simultaneously disclosing the same information publicly.

- Additional information in the report of the Board of Directors (Alsah own members - the proportion of contributions of members and shareholders in the company

B- It established an office to respond to rumors.

But ,I find that procedures are not adequate thus, firms must compliance with:

- The existence of an audit committee.
- Achieve the quality of internal audit.

2- The Egyptian Stock Exchange:

It followed the following procedures to increase transparency:

- A_Create a database on the Internet on the stock exchange
- develop trading rooms and create an information center to respond to investors
- Establishment of a company Egypt to publish the full information about companies traded in the bourse.
- The announcement - in 2010- of the index of the Environmental, Social Responsibility and Governance (ESG), which was prepared with the Standard & Poor's and the Egyptian Institute of Directors, and thus Egypt became the first African country to apply this indicator and the second developing country, after India ***(Egyptian Corporate Social responsibility Center,2010)***

However, these measures are inadequate, where you must create a site for each company on the Internet, which enables immediately update of the data.

3 - The Egyptian Association of Securities

It is issued a so-called Investor's Guide, which helps investors to read and understand financial statements.

However, this Guide evidence is also insufficient because it does not include non-financial information such as the risk of competition

In addition to these efforts, there are:

- Rules and standards guide of corporate governance 2005, which regulates the work of the General Assembly of Shareholders and the Board of Directors, but that rules are indicative not binding to application these rules (except the working companies in the field of securities is obliged since 2007), and that rules are less .

- Corporate governance principles Guide in 2006, which represents the legal and regulatory framework for public sector companies

In light of the above, it is clear that the level of transparency in Egypt is low, which means that there is asymmetry of information in the Egyptian capital market, thus, researcher sees to increase transparency in Egypt, it depends on two basic specific : timing and method of dissemination of information, therefore, the researcher suggests the following:

1. Attention to non-financial information –additional to the financial information and the method of presented in the notes (attached tables or peripheral notes).
2. Expanding the scope of mandatory disclosures by binding to the companies by the authorities in charge (the Stock Exchange and the Capital Market Authority) and not enough to provide instructions.
3. Supporting the electronic disclosure through creating of web-site for each company and making link with the web-site of the stock market, so as to provide timely information to the user, and the possibility of modernization and immediate knowledge of investors-you-go responses (feedback), thus reducing the asymmetry of information.
4. Companies must adopt the social role and included in the published reports.

7. Future research:

Given the importance of transparency in the stock market, that creates a fruitful environment in accounting research in different directions in this area, so the researcher proposes to conduct some research relating to:

1-The effect of using the language of XBRL in financial reporting to improve transparency - application in Egypt.

2- The impact of financial reporting transparency on the quality of information and the investors' decisions in the Egyptian stock market.

3- The impact of the voluntary application of IFRS standards on the transparency of financial reporting in Egypt.

4- The expected Role of Egyptian accounting Standards to enhancing corporate transparency.

8. Conclusion

Good T&D mechanisms are set in place to essentially protect the rights of the minority shareholders, creditors and other outside decision makers who do not have first hand knowledge about the firm and its prospects, from extraction of private benefits by insiders based on their superior information, This, in turn, is expected to minimize information asymmetry and the probability of fraud, also enhancing its easier detection, leading to lower cost of capital and hence higher firm value. A related informational advantage of good T&D practices is that it increases investor awareness and trust which will reduce the uncertainty of the returns to capital suppliers which, again, is expected to reduce the firm's cost of external capital and hence increase its value A third advantage is that compliance with good T&D practices mitigates the political costs of non-compliance and hence reduces the risk of higher taxes, litigation and too much regulation. These relationships and expected benefits of T&D are more important for capital markets.

English References:

Aksu, M.,(*2006)*' Transparency & Disclosure in the Istanbul Stock Exchange: Did IFRS Adoption and Corporate Governance Principles Make a Difference?", **Working paper**, *Sabanci University, Istanbul, Turkey*.

Armstrong C., Balakrishnan K., Cohen D.,(2012), "Corporate governance and the information environment: Evidence from state antitakeover laws", **Journal of Accounting and Economics,** In Press.

Ball R. , Jayaraman S., Shivakumar L.,(2011) "The Effect of Mark-to-Market Accounting for Trading Securities on Financial Reporting Transparency and Information Asymmetry in Banks", **Working Paper No. 11-43**, University of Chicago Booth School of Business

Barth M., Konchitchki Y., Landsman W.*, (2008),"* Cost of Capital and Earnings Transparency", **Research Paper No. 2015,** Graduate School of Business, Stanford University

Bushman R., and Smith A., (2003),"Transparency, Financial Accounting Information and Corporate Governance ", **FRBNY Economic Policy Review.**

Bushman ,R ., Piotroski , J and Smith A.,(2004) " What Determines Corporate Transparency " , *Journal of Accounting Research* , vol.42 , 2004 , pp.207-252

Cheng C., Collins D., Huang, H.,(2006),"Investors' Interpretations of the October 15, 2002 Standard & Poors Transparency & Disclosure Rankings" **Working Paper**

Egyptian Corporate Social responsibility Center,(2010)," Egyptian Corporate Social responsibility Index***",www.ecrc.org.***

Francis, J., Huang, S., Khurana I., (*2009),"* Does Corporate Transparency Contribute to Efficient Resource Allocation ,**Journal of Accounting Research,**Volume 47, Issue 4.

Grüning M. , (2010), "Artificial Intelligence Measurement of Disclosure (AIMD)", **European Accounting Review**, Forthcoming

Hassan O**.,** Romilly P**.,** Giorgioni G., Power D., (2009**),"** The value relevance of disclosure: Evidence from the emerging capital market of Egypt", **The International Journal of Accounting**, Volume 44, Issue 1,

Hermalin*, B.,* Weisbach*, M., (*2007*)"* Transparency and Corporate Governance", **Working Paper**

Hsieh, T., (2011), “Do the results of information transparency reflect firms’ accounting quality?”, **African Journal of Business Management,** Vol. 5, No..26.

http://www.alqabas.com.kw/Article.aspx?id=753885

Hunton J., Libby R., Mazza C.,(2004),” Financial Reporting Transparency and Earnings Management”, **Working Paper**

Jian, M., and Wong T., (2006) “Earnings Management and Tunneling Through Related Party Transactions: Evidence from Chinese Corporate Groups.”, **Working paper**, Nanyang Technological University.

Kim Y., Park M., Wier B., (2010),” Is Earnings Quality Associated with Corporate Social Responsibility?”, **The Accounting Review**, Forthcoming

Lambret R., Leuz C., and Verrecchia R., (2007) “Accounting Information, Disclosure, and the Cost of Capital.” **Journal of Accounting Research**, *Vol.* 45

Lang M. & Maffett, M. ,(2011 b).” *Economic Effects of Transparency in International Equity Markets: A Review and Suggestions for Future Research*

Lang, M., Maffett, M., (2011 a), Transparency and liquidity uncertainty in crisis periods, Journal of Accounting and Economics, forthcoming.

Leuz C., Verrecchia, R.,(2000),” The Economic Consequences of Increased Disclosure**”, Forthcoming Journal of Accounting Research Supplement**

Ng J.,(2010), “The Effect of Information Quality on Liquidity Risk” ,**the JAE conference.**

OECD, (2004), "OECD Principals of Corporate Governance, Organization for Economic Co-operation and Development (OECD)", **http/www.oecd.org**.

Patel, S., Balic, A., Bwakira, L., (2002), “Measuring transparency and disclosure at firm level in emerging markets”, **Emerging Markets Review** ,Vol. 3.

Sadka R.,(2011),” Liquidity risk and accounting information”, **Journal of Accounting and Economics**, Volume 52, Issues 2-3.

Schuster W., Hjelström A.,(2008),“Transparency Of Financial Reporting Information: The Case Of Impairment Testing Of Goodwill”, **Working paper**.

Stulz R., (2009), “Securities Laws, Disclosure, and National Capital Markets in the Age of Financial Globalization.” **Journal of Accounting Research,** Vol**.** 47.

Arabic References:

السهلي، محمد بن سلطان القباني ،(2011)، " مؤشر مقترح لقياس مستوى الشفافية والإفصاح في الشركات السعودية"، **مجلة البحوث المحاسبية**.

عبد الملك، أحمد رجب ،(2006)، " إطار مقترح للتقارير المالية المنشورة في ظل تحقيق الشفافية المنشودة ببورصة الأوراق المالية" ، **المجلة العلمية للبحوث التجارية** ، كلية التجارة وإدارة الأعمال ، جامعة حلوان.

وهبة، محمد سليم، (2005)،" البيانات المالية ومعايير المحاسبة الدولية "، **المحاسب المجاز**، العدد 23

The* Methodology for standard & Poor's T&D score*, as briefly described as follows:

The T&D score are developed from the analysis of the latest available annual reports, and assess the level of transparency and disclosure of companies in emerging markets (Asia, Latin America, Central and Eastern Europe, and Africa) as well as developed markets (Europe, developed Asia and the US).

Transparency and disclosure is evaluated by searching company annual reports (both English and local language) for the information of 98 possible attributes broadly divided into the following three subcategories:

(a) Ownership structure and investor relations (28 attributes);
(b) Financial transparency and information disclosure (35 attributes);
(c) Board and management structure and process (35 attributes).

Each question is scored on a binary basis to ensure objectivity, and scores for the three broad subcategories and an overall score are developed from scores on individual questions.

Example questions

(1) Ownership structure and investor relations

Does the annual report contain:
(a) A description of the share classes?
(b) A review of shareholders by type?
(c) A description of the voting rights?

(2) Financial transparency and information disclosure

Does the annual report contain information on:
(a) The company's accounting policy?
(b) Consistency of company accounting with the international accounting standards (IAS or US GAAP)?
(c) Efficiency indicators (return of assets, return on equity, etc.)?

(3) Board and management structure and processes

Does the annual report contain:
(a) A list of board members?
(b) A list of board committees?
(c) Audit committee?
(d) Details of directors' remuneration and details of performance related pay for directors?
(e) Related party transactions?